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No. 5

In the Supreme Court of the United States

OCTOBER TERM, 1940

HARRY H. NEUBERGER, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

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OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 20–23) is reported at 37 B. T. A. 223. The opinion of the Circuit Court of Appeals (R. 46–47) is reported in 104 F. (2d) 649.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on June 29, 1939 (R. 53). The time within which to file a petition for a writ of certiorari was extended for a period of 60 days from

September 26, 1939, by an order on that date signed by a Justice of this Court (R. 54). The petition for a writ of certiorari was filed on November 21, 1939, and granted on May 27, 1940, limited to the second and third questions presented (R. 55). The jurisdiction of this Court rests upon Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

The second and third questions, as stated in the petition for a writ of certiorari (Pet. 2), are:

1. Whether, under Section 23 (r) of the Revenue Act of 1932, petitioner, engaged in the business of trading in securities, may offset losses on the sale of noncapital securities owned by him as an individual, against profits from the sale of noncapital securities owned by him and another as partners.

2. Whether, if construed to deny such offset, Section 23 (r) of the Revenue Act of 1932 is constitutional, as applied in this case, where petitioner's business activities in trading for his own account and for the account of the partnership against whose profits he seeks to offset his losses were interwoven in one continuous course of business.

STATUTES INVOLVED

The relevant provisions of the statutes involved are set forth in the Appendix, *infra*, pp. 39-45.

STATEMENT

The pertinent facts, as stipulated (R. 12–19) and as found by the Board of Tax Appeals (R. 20–22), may be summarized as follows:

Petitioner, a resident of New York, was a member of the New York Stock Exchange. He was engaged in the business of trading in securities on the floor of the Exchange for the partnership of Hilson & Neuberger, of which he was a member, executing orders on behalf of customers of the partnership and for his individual account (R. 20–21).

During the year 1932, petitioner sustained a net loss of $25,588.93, on his individual trading, from sales or exchanges of stocks and bonds which were not capital assets as defined in Section 101 of the Revenue Act of 1932 (R. 12, 14).

During the same year Hilson & Neuberger, as a partnership, derived a profit of $142,802.29 from sales of stocks and other securities which were not capital assets as defined in Section 101 of the Revenue Act of 1932. The firm had other income of $170,830.65, and deductions of $203,981.78, or a net income of $109,651.06 (R. 13, 21). Petitioner's distributive share of the partnership profits amounted to $44,158.55 (R. 13, 15, 21).

Petitioner in his 1932 tax return deducted from his taxable income the loss of $25,588.93 [1] sustained

[1] This item is shown on the return as $27,096.88 (R. 15), but was adjusted by agreement of the parties to $25,588.93 (R. 12).

in his individual transactions in noncapital assets (R. 15, 17–19). The Commissioner disallowed the deduction and determined a deficiency (R. 8–10, 20).

The Board of Tax Appeals, on review, upheld the action of the Commissioner disallowing the deduction for the loss of $25,588.93 sustained by petitioner in his individual transactions in noncapital assets (R. 22–23).

On appeal, the Circuit Court of Appeals for the Second Circuit (on the authority of its earlier decisions in *Johnston* v. *Commissioner,* 86 F. (2d) 732, certiorari denied, 301 U. S. 683, and *Davis* v. *United States,* 87 F. (2d) 323, certiorari denied, 301 U. S. 704) affirmed the decision of the Board on the ground that, under Section 23 (r) of the Revenue Act of 1932, the loss sustained by petitioner on his individual trading in noncapital assets could not be offset against his share of the profits realized by a partnership from its trading in similar noncapital assets, and that Section 23 (r), as thus construed, was constitutional (R. 47).

This Court granted certiorari limited to the issues concerning the construction and constitutionality of Section 23 (r) (R. 55).

SUMMARY OF ARGUMENT

Section 23 (e) and (r) of the Revenue Act of 1932 provides that, in the case of an individual, a deduction from gross income will be allowed for

losses sustained from sales or exchanges of non-capital stocks and bonds (as defined in Sections 23 (r) and 101) only to the extent of the gains realized from similar sales or exchanges. A partnership, by Section 183, is allowed the same deductions from its gross income as in the case of an individual. Both the partnership and the petitioner, therefore, have been allowed the deduction authorized by Section 23 (e) and (r).

Petitioner here claims the right to another deduction, in addition to that specifically allowed by Sections 23 (e) and (r) and 183, from the gross income of the partnership. His apparent position requires that items of partnership *gross* income be used in the computation on his individual return.

The general scheme of the 1932 Act for computing and taxing partnership net income, following the pattern established in 1918, negatives the claim to use such a method of computation as that advocated by petitioner. Under that scheme, the partnership group is a net-income computing and reporting unit and only the end result of the computation of net income finds its place in the return of the individual partners. The position taken by petitioner ignores the fact that the partnership is the net-income computing unit while each individual partner is the tax-paying unit. Gross income received by the partnership can be offset only by deductions for losses sustained by the partnership. There is abundant evidence illustrating the fact

that the general scheme of the Act is as explained. Sections 184, 185, 186, and 188 concededly would all become mere surplusage under the contention advanced by petitioner. The "general rule" expressed in Section 182 (a), that his distributable share of the partnership "net income" shall be included in computing the net income of the individual partner, is inconsistent with the contention of petitioner that items of partnership gross income may be included in the computation on his individual return. The Act of 1938, moreover, carefully preserves this general scheme by *excluding* from the computation of partnership net income the items specifically authorized to be offset against like items from individual transactions. Congress specifically recognized that in making provision for such an offset it was changing the existing law under the Acts of 1934 and 1936 which are similar, in this respect, to the Act of 1932.

None of the authorities cited by petitioner are persuasive. All instances of administrative construction, with one possible exception, are concerned with credits against tax and credits against net income. Such credits do not become applicable until *after* the amount of net income has been determined. Accordingly, they have no bearing upon the method of computing net income under the Act and furnish no support for petitioner's claim to take an additional deduction from gross income realized by the partnership. The one pos-

sible exception was made to meet a special situation. The grants of specific statutory authority to take credits, likewise relied upon by petitioner, clearly support the Government because under petitioner's view they would be mere surplusage.

The issue before this Court arises only under Sections 23 (e) and (r) of the Revenue Act of 1932. The administrative and judicial construction of these provisions on the precise issue raised in this case has been uniform and undeviating. It is submitted that, in these circumstances, such construction should be determinative. And this conclusion is fortified by the established rule, repeatedly recognized by this Court, that a claimed deduction from gross income must be denied in the absence of clear and specific statutory authorization. *New Colonial Co.* v. *Helvering,* 292 U. S. 435, 440; *Burnet* v. *Thompson Oil and G. Co.,* 283 U. S. 301.

Section 23 (r) as applied is clearly constitutional. The claim made by petitioner is a claim to a deduction from gross income. Such a deduction is authorized only as an act of legislative grace. It follows that conditions and limitations upon the method of computing the deduction are within the complete discretion of Congress. Petitioner has no standing to protest that Congress should have been even more generous. Section 23 (r), in any event, is valid. Its legislative history demonstrates that reasonable men might per-

ceive that in fact different consequences result from speculation in securities than result from other types of speculation. Congress may act on these differences.

ARGUMENT

I

THE ACT FORBIDS THE CLAIMED DEDUCTION

The first question presented upon this review raises an issue concerning the proper construction of subsections (e) and (r) of Section 23 of the Revenue Act of 1932. Subsection (e) states the general rule that in computing net income there shall be allowed as deductions from gross income, in the case of an individual, subject to the limitations in subsection (r), losses sustained during the taxable year (not compensated for by insurance or otherwise) if incurred in trade or business or in any transaction entered into for profit. The deductions thus authorized are then limited by the provision in subsection (r) that losses from sales or exchanges of stocks and bonds which are not capital assets (as defined in Section 101) shall be allowed only to the extent of the gains from such sales or exchanges (including gains which may be derived by a taxpayer from the retirement of his own obligations).

The facts upon which this issue arises may be described in this wise: The partnership of which petitioner was a member derived a net profit (in excess of all gains offset by losses, if any) from

sales of noncapital stocks and bonds (as described in Sections 23 (r) and 101) of over $140,000. His distributive share of the total net profit of the firm (total gross income less total deductions allowed) amounted to $44,158.55. Petitioner as an individual realized a net loss (in excess of all losses offset by gains) from individual sales and exchanges of similar securities in the amount of $25,588.93. This proceeding comes before this Court to test his asserted right, under subsections (e) and (r), to deduct the net loss of $25,588.93 sustained in his individual transactions from the net profit of $44,158.55 attributable to firm activities and distributable to him by virtue of his firm membership.

The precise nature of the claim advanced by petitioner should be clearly understood at the outset. Subsections (e) and (r) allow him to deduct from his gross income all losses sustained from his individual transactions in noncapital securities to the extent of the gains from such transactions; petitioner took full advantage of the deduction thus allowed. Subsections (e) and (r), together with Section 183,[2] also allow the partnership in computing its net income to deduct from its gross income all the losses sustained, to the extent of the gains

[2] Section 183 reads: "The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual, except that the so-called 'charitable contribution' deduction provided in section 23 (n) shall not be allowed."

realized, from its transactions in noncapital securities; the partnership presumably took full advantage of this deduction. It is evident, therefore, that the partnership and the petitioner have been treated as separate individuals for the purpose of computing net income, and that each has been allowed the full deduction from gross income which subsections (e) and (r) authorize in the case of an individual. The petitioner, not satisfied with the deduction from gross income specifically allowed (by Sections 23 (e), 23 (r) and 183) in computing the net income of a partnership, now asserts the right to an additional deduction from the partnership gross income from its noncapital security transactions which is, allegedly, the source of the net income distributable to him.

The Government's position is that the scheme of the Act for computing and taxing partnership net income negatives the existence of a right to such a deduction and that, in any event, under settled rules of construction, a claim for a deduction not specifically authorized by the Act must be denied.

1. THE CLAIMED DEDUCTION MUST BE DENIED UNDER THE GENERAL SCHEME OF THE ACT

The general scheme of the Revenue Act of 1932 for computing and taxing partnership net income follows the pattern first introduced in the 1918 Act and repeated in all subsequent Acts. Every partnership, by Section 189, is required to make a return for each taxable year stating specifically

the items of its gross income and the deductions from gross income allowed by the Act. The net income of the partnership, thus to be reported, is required by Section 183 to be computed in the same manner and on the same basis as in the case of an individual (except for the so-called charitable contribution). Among the deductions entering into the computation of the partnership net income is the deduction allowed, in the case of an individual, by subsections (e) and (r) of Section 23. See Section 183. The net income of the partnership is not taxed directly to the firm as such. Individuals carrying on business in partnership are by Section 181 made liable for income tax only in their individual capacity. In order to subject the partnership net income to taxation, therefore, Section 182 lays down the general rule that there shall be included in computing the net income of each partner his distributive share, whether distributed or not, of the net income of the partnership for the taxable year.

It is evident that the partnership, under this general scheme, acts as a net-income computing and reporting unit. No other method of computing the net income attributable to the activities of the firm is mentioned or described in the Act. The net income thus computed is then, by Section 182, required to be included in computing the net income of the individual members of the firm. The deduction here claimed by petitioner, quite evidently, would never arise under the method and manner of

computation specifically described. Accordingly, in order to support his claim, petitioner must assert the right to recompute the items of gross income and the allowable deductions from gross income. Petitioner (Br. 5, 9, 14, 17, 23) would find authority for such a recomputation in a general principle, assertedly pervading all the revenue acts from 1913 to 1932, inclusive, whereby "items of partnership income retain the same character on individual partners' returns as they had on the partnership return."

This statement of the so-called general principle is conveniently, if not designedly, vague. The merest glance at Section 23 (e) and (r) discloses that the deduction there allowed may be taken, in the case of an individual, only from the gross income (total gain) realized from sales or exchanges of non-capital securities. There is no authority anywhere in the Act for taking this deduction, for losses sustained in noncapital security sales, from net income. Accordingly, in order to come within Section 23 (e) and (r), a partner asserting a claim like petitioner's must ascertain, as a distinct item, the gross income (total gain) derived from the sales of noncapital securities by his firm. Only in that event can the individual partner, in computing his net income, find the essential basis for the deduction allowed by Section 23 (e) and (r). There are two methods, conceivably, by which the individual partner might ascertain the gross income

(total gain) derived from the sales of noncapital securities by his firm. The most obvious method is to report on his individual return, as his gross income, his share of the item reported on the firm return as its gross income (total gain) from the sale of noncapital securities. But, if one item of gross income on the partnership return be reported (according to share) as an item of gross income on the individual return, then clearly all other gross income items should be so reported. Likewise, all items of deductions from gross income (for expenses, interest, taxes, and losses) should be so reported. This method would result in an amalgamation of (a share of) the gross income and deductions of the partnership group with the gross income and deductions of each individual partner.

The other method of ascertaining the basis for the deduction allowed by Section 23 (e) and (r)—that is, the gross income (total gain) derived from sales or exchanges of noncapital securities—would start with the figure reported as its *net income* on the return of the partnership. Each partner would then trace (his distributive share of) the net income to its source so as to ascertain what amount of the net income, if any, was attributable to the gross income (total gain) derived from the sales of noncapital securities. It appears to be beyond dispute that the net income must be broken down in such a manner. For, obviously, there is no authority allowing a deduction from that net in-

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come as such. And, be it noted, this is true even though the firm net income is reported on the return of the individual partner (according to his share) as his gross income. Section 23 (e) and (r) allows a deduction only from the gross income (total gain) *derived from sales of noncapital assets.* But, in tracing the firm net income to its source, under this method, it is not enough to ascertain merely the amount of gross income (total gain) from sales of noncapital securities reported on the return of the partnership group. Nor is it enough to ascertain merely the amount of net gain (total gain less total losses allowed as deductions) from sales of noncapital securities reported on the firm return. Items of total gain or net gain, from such transactions, might be reported on the return of the partnership and yet all of its *net income* might be derived from other sources. The reason for this is that many items, other than losses from sales of noncapital securities, are allowed as deductions from gross income from all sources. Thus office rent, salaries, taxes, and bad debts are allowed as deductions from the total gross income received by the partnership group, without regard to source. In the return of the petitioner, for example, deductions of over $200,000 were allowed from the total gross income from all sources (R. 13, 21). Partnership *net income* is thus the result of a computation, subtracting total allowable deductions from total gross income. In order to trace partnership *net income* into particular items of gross income,

obviously, the total allowable deductions must be allocated among the total gross-income items. And, it follows, in order to trace firm *net income* into *gains from sales of noncapital securities,* a similar allocation of deductions would have to be made in the case at bar. No such allocation was attempted, or even suggested, by petitioner. It would appear, therefore, that petitioner has in mind and is relying upon the method of ascertaining the gains from noncapital-security transactions first described.[8]

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[8] The converse of the situation here presented serves in dramatic fashion to illustrate our point. If the partnership has excess noncapital security *losses*, and the individual member excess similar *gains*, the losses, if they would be offset, would have to be used directly in the return of the individual member. Such losses could not be the source of positive net income; and "certainly the average man suffering a net loss from the operations of his business would learn with surprise that, within the meaning of the Congress, the amount of his net loss was also the amount of his net income." *Woolford Realty Co.* v. *Rose*, 286 U. S. 319, 327. Compare *Ardenghi* v. *Helvering*, 100 F. (2d) 406, 407 (C. C. A. 2d).

If, however, petitioner should claim to be relying upon the second method, the necessary facts upon which to base the deduction authorized by Section 23 (e) and (r) do not appear in the record. There is no reason to assume that the deductions of $203,981.78 should be allocated, in whole or in part, to the income from sources other than the sales of noncapital securities. And, even if an arbitrary allocation were made in proportion to the items of gross income, petitioner's distributive share of the firm net income, attributable to security transactions, would be only approximately $20,000.

In any event, we submit, such a method of computation is contrary to the scheme of the Act. It would require an individual partner to go behind the return of the partner-

There remains for consideration the question whether a general principle, contemplating such a method of computation, can be reconciled with the scheme of the Act.

Any such principle, if it existed, would render meaningless the provisions embodied in Sections 184, 185, 186, and 187. Section 184 states that a partner, for the purpose of the normal tax, shall be allowed as a credit against his net income, in addition to the credits allowed to him under Section 25, his proportionate share of such amounts of dividends and interest specified in Section 25 (a) and (b) as are received by the partnership. Such dividends and interest, if there existed any such principle as advocated by petitioner, would have been treated as received by each partner individually and would have been covered by Section 25 (a) and (b). Similarly, Section 185 provides for an "earned income" credit; Section 186 has special provisions for taxing "capital net gains

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ship and to make an allocation of deduction items according to information not reported on the firm return. The partnership returns used for the past 20 years would, under such a method, cease to be "information" returns in any real sense either to the Commissioner or to the taxpayer. None of the returns required by the Commissioner, since the Act of 1918, has ever provided for such an allocation of deduction items as would be required under this method. This continuous, undeviating construction of the Act, with reference to the information to be required on a partnership return, demonstrates persuasively that this method of computation, requiring other information, is clearly erroneous and contrary to the scheme of the Act.

and losses" included in the partnership net income; and Section 188 allows as a credit against the tax of the member, to the extent provided in Section 131, the amount of income, war profits, and excess-profits taxes imposed on the partnership by foreign countries or possessions of the United States. All these provisions, if petitioner is right, become mere surplusage. *Market Co.* v. *Hoffman,* 101 U. S. 112, 115; *Ex parte Public National Bank,* 278 U. S. 101, 104; *Ginsberg & Sons* v. *Popkin,* 285 U. S. 204, 208. See *Botany Mills* v. *United States,* 278 U. S. 282, 289.

Such a principle, moreover, is directly contrary to the "general rule," expressed in Section 182 (a), that the net income of the partnership distributable to a partner shall be included in computing his individual net income. There is no intimation in Section 182 (a) that items of partnership gross income and allowable deductions for losses sustained shall be included in the return or in the computation of the net income of the individual member of a partnership. On the contrary, the inclusion of such items cannot be reconciled with the sole direction to include in the computation the net income distributable to the member. Since Section 182 (a) is specifically designated as the "general rule," it follows that the inconsistent general principle relied upon by petitioner arises, if at all, independently of any intention expressed by Congress.

Furthermore, the changes made by Congress in enacting the Revenue Act of 1938 are persuasive evidence that the scheme of computation advocated by petitioner was never authorized under the 1932 Act. Section 182 of the 1938 Act provides specifically that, in computing the net income of each partner, he shall include as part of his short-term capital gains or losses his distributive share of the net short-term gain or loss of the partnership. And, it should be noted, Section 183 carefully *excludes* such gains or losses from the computation of the net income of the partnership. These specific provisions enabling short-term capital net losses or gains of the partnership to be offset by like individual net gains or losses were recognized by Congress as a departure from the principle adopted in the Revenue Acts of 1934 and 1936. See Report of the Ways and Means Committee, H. Rep. No. 1860, 75th Cong., 3d Sess., pp. 42–43. In those previous Acts, as the petitioner concedes (Br. 33), the deduction for partnership security losses was allowed only to the partnership as a net income computing unit and was not allowed to the individual partners. The Committee Report notes the change made by the 1938 Act.

Yet the occasion for such an offset was the same under the 1934 and 1936 Acts as under the 1932 Act here involved. All assets were treated under the Acts of 1934 and 1936 (Section 117) as capital assets regardless of the time held and the recognized capital gain or loss was taken into account in com-

puting net income to the extent of a percentage of such gain or loss dependent upon the length of the period during which the asset sold was held. Each Act had a further provision, in Section 117 (d), that losses from sales or exchanges of capital assets should be allowed only to the extent of $2,000 plus the gains from such sales or exchanges. In the event an individual during the years 1934 to 1937 sustained losses from sales of securities greatly in excess of his gains from sales of securities or other assets, even as did the petitioner in the case at bar, his advantage would have been served by asserting the right to offset his individual losses against the gains realized by his partnership from like sales to the extent of his share of such gains. And, if any such general principle as that for which petitioner contends were valid, the right to make such an offset would be clear in the absence of a specific provision forbidding the offset. But the 1934 and 1936 Acts may be searched in vain for any such provision.

Quite to the contrary, a specific provision in Section 182 of the 1938 Act was required to accomplish the result desired by petitioner. And that specific change was accompanied by a corresponding change in the computation of the net income of the partnership; the items which Section 182 authorized to be offset were excluded by Section 183 from the computation of firm net income. The reason that this was done completely refutes the argument advanced by petitioner.

And this reason was concisely explained in the Report of the Ways and Means Committee on the 1938 Act (at p. 42):

> Partnerships are not treated by the revenue act as taxable entities and hence, as such, pay no tax to the Federal Government. *Yet they are regarded as business and accounting units and as such are required to compute their net income in the first instance as individuals, distinct from the natural persons composing them,* and to file returns in the nature of information returns showing the partnership net income. *After the partnership net income has been thus computed, the law requires the individual partners to include* their proper portions of *such net income,* whether or not actually distributed to them by the partnership, *in their own returns in computing their net incomes* as individuals for tax purposes. [Italics supplied.]

This, in short, is our position. The general scheme of the 1932 Act regards a partnership as an accounting unit for the purpose of computing its net income in the same manner as any other individual and requires the net income thus computed to be included in computing the net income reported by the individual members of the firm. Hence, any deductions allowed, in the case of an individual, for losses sustained, may be offset by an individual partner against his individual gross income and may be offset by a partnership against its firm gross income. But, in the absence of a

specific authorization, as in the 1938 Act, losses, allowable as deductions, and sustained by a member of a partnership, may not be offset against the gross income of the firm.

The Act of 1938 carefully refrains from modifying this general scheme whereby items entering into the net income computation on the return of the partnership lose their identity and the net income is reported by the individual members as thus computed. The net income computed on the return of the firm under the 1938 Act is still reported by the individual partners as thus computed; the items of capital gain or loss from firm transactions which may be offset against like items from individual member's transactions are expressly excluded from the computation of net income on the return of the firm. Quite evidently, therefore, the argument that the 1938 Act was intended to be declaratory of the proper construction of the Act of 1932 has no validity. The 1932 Act, by Sections 22, 23 (e) and (r), and 183, expressly provides that losses and gains from sales of noncapital stocks and bonds shall enter into the computation of the net income of the partnership on its return. Accordingly, under the general scheme, still followed in the 1938 Act, such items lose their identity and the net income computed by the firm is reported, as thus computed, by its individual members. The deduction here sought by petitioner requires a method of computation directly counter to this general scheme.

Other instances where the method of computation urged by petitioner has been rejected may be mentioned. Thus, a partner in his individual return may not deduct from gross income sums expended by himself where such sums are ordinary and necessary business expenses of his firm. *Wilson* v. *Commissioner,* 17 B. T. A. 976, appeal dismissed, 55 F. (2d) 1086 (C. C. A. 10th); OD 593, Cum. Bull. 3, p. 130. Similarly, a partner may not take as a deduction from the gross income reported in his return his proportionate share of a bad debt owing to the firm. *Menken* v. *Commissioner,* 8 B. T. A. 1062. These are simple, and obvious, illustrations of the general rule that items entering into the computation of net income on the return of a partnership cannot be used in computing the net income of the individual partners.

One of the clearest examples of the general scheme under which a partnership is utilized as the net-income computing unit is shown by the decision of this Court in *Shearer* v. *Burnet,* 285 U. S. 228. The taxpayers there, who were on a calendar year cash basis, were members of a law partnership which kept its books on the basis of a fiscal year ending April 30th. The partners in their individual returns for the year 1924 included, as was required by Section 218 (a), their respective shares of the partnership profits for the partnership fiscal year ending in 1924. They thus returned, as 1924 net income, partnership profits earned by the partnership during eight

months of the preceding year. In the Revenue Act of 1924, by Section 1200 (a), Congress authorized an allowance to taxpayers returning income for the calendar year 1923 of a credit or refund of 25 percent of the amount shown as the tax on each return. Section 1201 (a) and (b) authorized a similar allowance to taxpayers returning income for a fiscal year beginning or ending in 1923, but only with respect to the tax on so much of the income returned as was attributable to income earned in the calendar year 1923. The taxpayers urged that the items of income received by the partnership and distributed to the partners should be treated as if received by the individual partners directly from the source instead of derivatively through the firm. By making such an argument, which is similar to the one here advanced by petitioner, the taxpayers claimed to come within the alleged intent of the statute to allow the 25 percent refund of tax upon any and all income attributable to the year 1923. This Court (285 U. S. at 232) refused to recognize any such principle which would ignore the firm as a net-income computing unit distinct from its members. See also *Colip* v. *Commissioner,* 5 B. T. A. 123; *Kurzman* v. *Commissioner,* 8 B. T. A. 412.

Yet another illustration is furnished by the case of *Burns* v. *Commissioner,* 12 B. T. A. 1209. The Board there held that a partner reporting on the cash basis was entitled to deduct his share of accrued foreign taxes imposed on his partnership,

reporting on an accrual basis. Decision was rested upon the principle that a partnership is the unit for computing the net income derived from firm transactions. Accord: *Forres* v. *Commissioner*, 25 B. T. A. 154.

The petitioner (Br. 23–24n.) dismisses these cases by simply asserting that they are immaterial and do not question the alleged "principle preserving the identity of partnership income in partners' hands." But, as we have demonstrated (*supra*, pp. 12–14), this so-called principle does not aid petitioner unless it permits items of gross income and deductions from gross income used in the computation on the return filed by the partnership to be used again in the computation of net income on the individual members' returns. These cases show in a persuasive fashion that such a computation is opposed to the general scheme of the Act.

Finally, it is to be observed, the converse of the situation presented in this case illustrates the untenable character of the position taken by petitioner. Suppose, for example, that a partnership realizes noncapital security gains of $1,000, and sustains noncapital security losses of $5,000; and that an individual member realizes noncapital security gains of $10,000 and sustains similar losses of $2,000. If petitioner's argument be sound, the partnership excess noncapital loss of $4,000 (disallowed to the partnership as such) should be offset against the individual excess gains of $8,000.

But, we submit, there is no authority whatever in the Act permitting losses *disallowed* as deductions to the firm to be offset against the net income of the individual partners.[4] The terminology of Section 182 (a), that only his distributive share of the *net income* of the partnership shall be included in the return of the individual partner, completely refutes the argument. Compare *Woolford Realty Co.* v. *Rose,* 286 U. S. 319, 327; *Ardenghi* v. *Helvering,* 100 F. (2d) 406, 407 (C. C. A. 2d).

2. THE AUTHORITIES RELIED UPON BY PETITIONER ARE NOT PERSUASIVE

In support of his position petitioner (Br. 17–18) relies upon specific authorizations in the revenue acts allowing an individual partner in the computation of his tax to take certain credits against tax and against the net income earned by his partnership and distributable to him. But none of these credits enter into the computation of net income on the return of the partnership. Thus, Section 184 provides merely that the partner shall, for the purpose of the normal tax, be allowed as a *credit against his net income* (in addition to credits allowed to him under Section 25) his proportionate share of such amounts of dividends and interest specified in Section 25 (a) and (b) as are received by the partnership. There is nothing in such a provision which militates against our position that

[4] Section 187, permitting the offsetting of "net losses," refers only to the excess losses *allowed* to the partnership. See Section 117.

the net income earned directly by the individual partners and the net income earned by the partnership group shall be computed separately and that items entering into the computation of net income on the return of the partnership shall not be used again in computing the net income of the individual partners. After the net income has been thus computed, and only then, credits against such net income become relevant for the purpose of determining the amount of the tax against the individual partners. The basic fallacy in the position taken by petitioner is that it ignores the fact that the partnership group is the net-income-computing unit while each individual partner is the tax-paying unit. The provisions in Sections 185, 186, and 188 likewise furnish no aid to petitioner for the same reason. Each of these provisions assumes that, prior to its application, the amount of net income has been computed; clearly, therefore, none of them changed the method of computing partnership net income. The computation still is made in the manner for which the Government here contends.

It may be noted, in addition, that the position advocated by petitioner would, as we have demonstrated (*supra*, pp. 16-17), render the provisions of Sections 184, 185, 186 and 188 mere surplusage. Far from aiding petitioner, therefore, his authorities bolster our case. *Market Co.* v. *Hoffman*, 101 U. S. 112, 115; *Ex parte Public National Bank*, 278 U. S. 101, 104; *Ginsberg & Sons* v. *Popkin*, 285

U. S. 204, 208. See *Botany Mills* v. *United States*, 278 U. S. 282, 289.

Petitioner (Br. 18–22) has also found three instances in which the Treasury Department, without express statutory authorization, has allowed credits and exemptions to individual partners by reason of the character of the gross income received by the partnership. An examination of this administrative practice discloses that, here too, the scheme of the Act for computing partnership net income was not intended to be modified. The statutory provisions governing the credit for taxes withheld at the source (Pet. Br. 20–22) may be taken as an example. Section 143 (a) of the Revenue Act of 1932 provides for withholding at the source a tax of 2% on bond interest paid to individuals and to partnerships. The income upon which tax is withheld at the source shall be included in the return of the recipient of such income, under Section 143 (d), "but any amount of tax so withheld shall be *credited against the amount of income tax* as computed in such return." (Italics supplied.) A partnership is not a *taxpaying* unit and, accordingly, does not compute a *tax* in its return. The credit against the *tax* could not possibly be of use to a partnership. It follows that, unless a tax on the bond interest shall be collected twice, the credit provided in Section 143 (d) must be given to the individual partners who pay the tax on the net income computed in the return of the partnership. As an administrative expedient, therefore, in order to carry

out the intent of Congress not to impose a double tax in this instance, the General Counsel of the Treasury ruled that, under the similar provisions of the 1934 Act, a credit against his tax should be allowed to each partner. G. C. M. 18120, 1937–1, Cum. Bull. 151. Quite evidently, however, such a credit has no bearing upon the manner of computing partnership net income. And the credit, moreover, is given only to the individuals and not to the firm. Clearly, the deduction here sought by petitioner, which requires a radical change in the manner of computing partnership net income, and which is in addition to a deduction specifically given to the partnership group, should not be granted in reliance upon the supposed analogy of such an administrative practice.

The other instances cited by petitioner are no more persuasive. Section 212 of the 1932 Act provides that gross income in the case of a nonresident alien individual includes only the gross income from sources within the United States. The General Counsel for the Treasury ruled that a member of a partnership carrying on business in the United States and in a foreign country, who was occupied solely with the business of the firm in the foreign country, and who received a so-called salary of definite amount chargeable first against the profits of the foreign office, should be treated as the recipient of income from sources without the United States to the extent the income of the

foreign office was available to make the distribution. G. C. M. 13771, XIII–2 Cum. Bull. 229 (1934), modified, G. C. M. 17255, XV–2 Cum. Bull. 243 (1936). Since the so-called salary was regarded as a distribution of partnership profits, the ruling that such profits should be regarded as derived from sources without the United States is not entirely consistent with the general scheme of the Act for computing and taxing partnership net income. It may be that Section 212 was given an extended application upon the supposed analogy of the credit provisions. Accord: *Craik* v. *United States,* 31 F. Supp. 132 (C. Cls.).[5] The rulings of the General Counsel contain no discussion of this issue and are concerned primarily with the question whether or not the distribution should be regarded as salary for personal services performed in a foreign country or as partnership profits. In any event, we submit, there was no intention to upset the entire scheme of computing net income of a partnership. The Treasury has consistently ruled, on the precise issue now before this Court, that a deduction such as petitioner claims, must be denied. G. C. M. 14012, XIV–1 Cum. Bull. 145 (1935). That ruling is still in force. And, since

[5] The Court of Claims, in the *Craik* case, limited its holding to the narrow issue before it. It did not disapprove of its own prior decision in *Klingenstein* v. *United States*, 18 F. Supp. 1015, or of the decision of the Second Circuit in *Johnston* v. *Commissioner*, 86 F. (2d) 732, both of which support our position on the precise issue in the case at hand.

it covers this very case, it should be given more weight than the ruling cited by petitioner.

The third instance relates to the treatment of interest on Government bonds. Interest on a principal amount in excess of $5,000 must be included in gross income. Section 22 (b) (4) of the 1932 Act. Article 89, Regulations 77 (Act of 1932) provides that each member of a partnership, and each beneficiary to whom the income of a trust is taxable, is entitled to exemption as if he owned directly a proportionate part of the bonds held by the partnership and held in trust, respectively. Plainly these provisions are based on the theory that the exemption should follow the *tax,* as indeed it must, in order to have any vitality. They are not intended to modify the method of computing net income, obviously, for they apply equally to a trust and to a partnership.

We submit that these instances of administrative practice do not support the position urged by petitioner.

The enactment of Section 218 (d) of the National Industrial Recovery Act sheds no clearer light on the issue raised in this case. The Report of the Senate Finance Committee (S. Rep. No. 114, 73d Cong., 1st Sess., p. 7), cited by petitioner (Br. 27), states that "under existing law the individual members of a partnership are entitled to reduce their individual net incomes by their distributive shares of a *net loss* incurred by the partnership. Your committee amendment denies this deduction to the

extent that the *net loss* is attributable to a loss from the sale or other disposition of stocks and bonds." [Italics supplied.] The term "net loss" as used in the revenue acts is a technical term and is specifically defined in Section 117 (a) of the 1932 Act. See 3 Paul and Mertens, *Law of Federal Income Taxation* (1934), § 27.01 *et seq.*, c. 27. The reference in the Committee Report to a deduction from individual income by the use of a partnership "net loss" may be a reference to Section 187 which specifically allows such a deduction. Section 187 has no bearing upon the issue before this Court.[6]

The petitioner is not aided even though the Report be thought to refer to some other section. Section 218 (d), as reported to the Senate (H. R. 5755, 73d Cong., 1st Sess., p. 41), reads:

> Effective as of January 1, 1933, section 182 (a) of the Revenue Act of 1932 is amended by inserting at the end thereof a new sentence as follows: "No deduction from gross income shall be allowed to a partner on account of any excess of the deductions allowed the partnership under this title over

[6] Section 187 of the Revenue Act of 1932 was specifically repealed by Section 218 (a) of the National Industrial Recovery Act. Despite the repeal, however, the purpose of Congress would not have been fully carried out without the enactment of Section 218 (d) of the National Industrial Recovery Act. Otherwise net losses under the 1928 Act would have been carried over to 1933. Section 117 (b) of the Revenue Act of 1928 allowed a carry over to the *third* year after the net loss, so that the mere repeal of Section 187 of the Revenue Act of 1932 would not have prevented a carry over of a 1931 net loss to 1933.

> the gross income of the partnership to the extent that such excess is attributable to loss from the sale or other disposition of stocks and bonds as defined in section 23 (t)."

Losses from the sale of stocks and bonds (as defined in section 23 (t)) might be either *capital* losses (Section 101) or *noncapital* losses (Sections 23 (r) and 101). Section 186 of the 1932 Act specifically allows *capital* gains or losses of a partnership to be offset against *capital* losses or gains of the individual partners. The Committee Report, cited by petitioner (Br. 27), had reference to the legislation in the form which *deprived* individual partners of a deduction on account of partnership *capital* losses. The Committee was therefore correct in stating that such legislation changed existing law. But it changed the existing law affecting *capital* losses. The final form of the legislation was limited to noncapital losses. The net result was a positive statutory distinction between the method of treating the two types of losses. *Capital* losses or gains of a partnership could be offset against individual *capital* gains or losses; *noncapital* gains or losses could not be so offset.

In our view Section 218 (d) of the National Industrial Recovery Act was "but a clarification of existing law." *Johnston* v. *Commissioner,* 86 F. (2d) 732, 734. At any rate it is clear that "any loss *disallowed* to a partnership as a deduction by Section 23 (r)" could, under no circumstances, affect the individual partners' tax for the year 1932.

Such a result was precluded by virtue of Section 23 (r) (2), which provides that losses disallowed by Section 23 (r) (1) should be considered as losses sustained in the *succeeding taxable year*. It is clear that neither the group nor the individual partners could receive any benefit from such losses in the year 1932. The result of selecting January 1, 1933, as the effective date of Section 218 (d), moreover, was to prevent the individual partners from ever realizing any benefits under Section 23 (r) (2) either in 1932 or later. Our contention here that individual partners are not entitled to use the excess noncapital partnership gains to offset their individual noncapital losses, is, therefore, entirely consistent with the practice with respect to excess noncapital partnership losses.

The primary reliance of petitioner is upon the early case of *United States* v. *Coulby,* 258 Fed. 27 (C. C. A. 6th), affirming 251 Fed. 982 (N. D. Ohio). It presented the issue whether, under Section 2 (b) of the 1913 income tax statute, an individual partner in computing his net income for the purpose of the normal tax could deduct his distributive share of partnership profits to the extent such profits were attributable to dividends received by the firm upon the stock of a corporation which was taxable upon its net income. The decision, allowing such a deduction to the partner, turned upon the specific provisions of the 1913 Act. Under that Act, no return was required from the partnership, and no provision authorized the

exclusion of such dividends in the computation of partnership income. Accordingly, in order to carry out the intention of Congress to exclude from net income and thus from tax the dividends of corporations which likewise paid a net income tax, an adjustment was permitted in the computation of the individual partners. This decision was in accordance with the provision in the Revenue Act of 1916, specifically allowing a deduction by the individual partners, and the court reasoned that the later enactment was a legislative recognition of the scope and intent of the 1913 Act. It is evident, therefore, that the *Coulby* case, arising under an act which did not require a partnership return, did not raise the issue, now before this Court, whether an individual partner may personally take a deduction which is in addition to a like deduction specifically allowed to the partnership, as such. And, unlike the subsequent enactment considered in that case, the Act of 1938 furnishes substantial support for the position here advocated by the Government. See pp. 18-21, *supra*.

3. THE UNIFORM ADMINISTRATIVE AND JUDICIAL CONSTRUCTION OF SECTION 23 (e) AND (r) SUPPORTS THE GOVERNMENT

The precise issue raised in this case is a narrow one which arises only under Section 23 (e) and (r) of the Revenue Act of 1932. The Treasury Department has decided this issue and has denied the claimed deduction. G. C. M. 14012,

XIV–1 Cum. Bull. 145; IT 2892, *id.*, 148. It has never modified its position.

Every case raising this issue before a federal court has likewise resulted in a decision rejecting the claim to the deduction.[7] *Johnston* v. *Commissioner,* 34 B. T. A. 276, affirmed, 86 F. (2d) 732 (C. C. A. 2d), certiorari denied, 301 U. S. 683; *Klauber* v. *Commissioner,* 34 B. T. A. 998, affirmed, 92 F. (2d) 1007 (C. C. A. 2d); *Winmill* v. *Commissioner,* 93 F. (2d) 494, reversed on another point, 305 U. S. 79; *Sartorius* v. *Commissioner,* 35 B. T. A. 1233, dismissed without opinion, January 26, 1938 (C. C. A. 2d), certiorari denied, 301 U. S. 688; *Klingenstein* v. *United States,* 18 F. Supp. 1015 (C. Cls.), certiorari denied, 301 U. S. 716. See also *Davis* v. *United States,* 87 F. (2d) 323 (C. C. A. 2d), certiorari denied, 302 U. S. 704; *Cohn* v. *United States,* 23 F. Supp. 534 (C. Cls.); *White* v. *Commissioner,* 37 B. T. A. 1106.

The petitioner would avoid the force of this uniform administrative and judicial construction by arguing, in effect, that to allow noncapital security losses of an individual partner to be offset

[7] *Jennings* v. *Commissioner,* 110 F. (2d) 945 (C. C. A. 5th), now pending on petition for certiorari, No. 231, this Term, raises the issue whether, under the 1936 Act, individual gambling losses may be offset against partnership gambling gains. The Treasury had ruled against the taxpayer. G. C. M. 21478, 1939 CCH, Vol. 3, par. 6455. The court's approach in the *Jennings* case, however, is inconsistent with our position here.

against noncapital security gains of the partnership would not be inconsistent with the purpose of Section 23 (e) and (r). Specifically he urges that the legislative history of Section 23 (r) shows that the purpose of Congress was only to prevent the deduction of speculative security losses from salaries, dividends, rents, and similar income. See H. Rep. No. 708, 72d Cong., 1st Sess., p. 12; S. Rep. No. 665, 72d Cong., 1st Sess., p. 10. But while the basic purpose of Congress was doubtless to prevent noncapital security losses from being applied against such ordinary income, Congress did not relieve noncapital security gains from taxation except as deductions were available under the statute to offset them, and the noncapital security losses sustained by a partnership specifically were allowed as deductions to be offset against its noncapital gains. There is nothing in the legislative history of Section 23 (r), therefore, which lends any support to the position taken by the petitioner.

It is submitted that, under the circumstances, the uniform administrative and judicial construction of Section 23 (e) and (r) should be determinative. Additional support for this construction is found in the established rule that, in the absence of a clear and specific statutory authorization, a claim of right to a deduction from gross income must be denied. *New Colonial Co.* v. *Helvering,* 292 U. S. 435, 440; *Burnet* v. *Thompson Oil & G. Co.,* 283 U. S. 301.

II

THE ACT IS CONSTITUTIONAL AS APPLIED

It is important to observe that the claim advanced by petitioner is a claim to a deduction from gross income. Section 23 (e) and (r). Such a deduction, as this Court has repeatedly recognized, is a matter of legislative grace. *New Colonial Co.* v. *Helvering,* 292 U. S. 435, 440; *Helvering* v. *Ind. Life Ins. Co.,* 292 U. S. 371, 381; *Denman* v. *Slayton,* 282 U. S. 514. It follows that the conditions and limitations as to the manner of computing the deductions are within the complete discretion of Congress. Petitioner, who has received the benefit of a deduction specifically allowed, has no standing to protest that Congress should have been even more generous. Compare *Perkins* v. *Lukens Steel Co.,* 310 U. S. 113, 125; *Tennessee Electric Power Co.* v. *Tennessee Valley Authority,* 306 U. S. 118, 137–138; *Alabama Power Co.* v. *Ickes,* 302 U. S. 464; *Massachusetts* v. *Mellon,* 262 U. S. 447.

The application of the statute, in any event, does not violate any provision of the Constitution. All taxpayers similarly situated are treated alike. The legislative history of Section 23 (r) demonstrates that reasonable men might perceive that speculation in securities is productive of consequences differing from those arising from other types of speculation. See S. Rep. No. 665, 72d Cong., 1st Sess.; H. Rep. No.

708, 72d Cong., 1st Sess. Congress clearly may act on such differences. *United States* v. *Hudson*, 299 U. S. 498; *Barclay & Co.* v. *Edwards*, 267 U. S. 442, 450; *Billings* v. *United States*, 232 U. S. 261, 282. Compare *Tigner* v. *Texas*, 310 U. S. 141, 147.

CONCLUSION

It is respectfully submitted that, for the foregoing reasons, the decision of the court below should be affirmed.

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APPENDIX

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) *Expenses.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

* * * * *

(e) *Losses by Individuals.*—Subject to the limitations provided in subsection (r) of this section, in the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or

(3) of property not connected with the trade or business, if the loss arises from fires, storms, shipwreck, or other casualty,

or from theft. No loss shall be allowed as a deduction under this paragraph if at the time of the filing of the return such loss has been claimed as a deduction for estate-tax purposes in the estate-tax return.

* * * * *

(r) *Limitation on Stock Losses.*—

(1) Losses from sales or exchanges of stocks and bonds (as defined in subsection (t) of this section) which are not capital assets (as defined in section 101) shall be allowed only to the extent of the gains from such sales or exchanges (including gains which may be derived by a taxpayer from the retirement of his own obligations).

(2) Losses disallowed as a deduction by paragraph (1), computed without regard to any losses sustained during the preceding taxable year, shall, to an amount not in excess of the taxpayer's net income for the taxable year, be considered for the purposes of this title as losses sustained in the succeeding taxable year from sales or exchanges of stocks or bonds which are not capital assets.

(3) This subsection shall not apply to a dealer in securities (as to stocks and bonds acquired for resale to customers) in respect of transactions in the ordinary course of his business, nor to a bank or trust company incorporated under the laws of the United States or of any State or Territory, nor to persons carrying on the banking business (where the receipt of deposits constitutes a major part of such business) in respect of transactions in the ordinary course of such banking business.

(s) *Same—Short Sales.*—For the purposes of this title, gains or losses (A) from short sales of stocks and bonds, or (B) attributable to privileges or options to buy or

sell such stocks and bonds, or (C) from sales or exchanges of such privileges or options, shall be considered as gains or losses from sales or exchanges of stocks or bonds which are not capital assets.

(t) *Definition of Stocks and Bonds.*—As used in subsections (r) and (s), the term "stocks and bonds" means (1) shares of stock in any corporation, or (2) rights to subscribe for or to receive such shares, or (3) bonds, debentures, notes, or certificates or other evidences of indebtedness, issued by any corporation (other than a government or political subdivision thereof), with interest coupons or in registered form, or (4) certificates of profit, or of interest in property or accumulations, in any investment trust or similar organization holding or dealing in any of the instruments mentioned or described in this subsection, regardless of whether or not such investment trust or similar organization constitutes a corporation within the meaning of this Act.

SUPPLEMENT F—PARTNERSHIPS

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

SEC. 182. TAX OF PARTNERS.

(a) *General Rule.*—There shall be included in computing the net income of each partner his distributive share, whether distributed or not, of the net income of the partnership for the taxable year. If the taxable year of a partner is different from that of the partnership, the amount so included shall be based upon the income of the partnership for any taxable year of the partnership ending within his taxable year.

* * * * * *

SEC. 183. COMPUTATION OF PARTNERSHIP INCOME.

The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual, except that the so-called charitable contribution deduction provided in section 23 (n) shall not be allowed.

SEC. 184. CREDITS AGAINST NET INCOME.

The partner shall, for the purpose of the normal tax, be allowed as a credit against his net income, in addition to the credits allowed to him under section 25, his proportionate share of such amounts of dividends and interest specified in section 25 (a) and (b) as are received by the partnership.

SEC. 185. EARNED INCOME.

In the case of the members of a partnership the proper part of each share of the net income which consists of earned income shall be determined under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary and shall be separately shown in the return of the partnership and shall be taxed to the member as provided in this Supplement.

SEC. 186. CAPITAL NET GAINS AND LOSSES.

In the case of the members of a partnership the proper part of each share of the net income which consists, respectively, of ordinary net income, capital net gain, or capital net loss, shall be determined under the rules and regulations to be prescribed by the Commissioner with the approval of the Secretary, and shall be separately shown in the return of the partnership and shall be taxed to the member as provided in this Supplement, but at the rates and in the manner provided in section 101 (a) and (b), relating to capital net gains and losses.

SEC. 187. NET LOSSES.

The benefit of the special deduction for net losses allowed by section 117 shall be allowed to the members of a partnership under regulations prescribed by the Commissioner with the approval of the Secretary.

SEC. 188. TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF THE UNITED STATES.

The amount of income, war-profits, and excess-profits taxes imposed by foreign countries or possessions of the United States shall be allowed as a credit against the tax of the member of a partnership to the extent provided in section 131.

SEC. 189. PARTNERSHIP RETURNS.

Every partnership shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed by this title, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners.

Revenue Act of 1938, c. 289, 52 Stat. 447:

SEC. 182. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

(a) As a part of his short-term capital gains or losses, his distributive share of the net short-term capital gain or loss of the partnership.

(b) As a part of his long-term capital gains or losses, his distributive share of the net long-term capital gain or loss of the partnership.

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183 (b).

SEC. 183. COMPUTATION OF PARTNERSHIP INCOME.

(a) GENERAL RULE.—The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual, except as provided in subsection (b) and (c).

(b) SEGREGATION OF ITEMS.—

(1) CAPITAL GAINS AND LOSSES.—There shall be segregated the short-term capital gains and losses and the long-term capital gains and losses, and the net short-term capital gain or loss and the net long-term capital gain or loss shall be computed.

(2) ORDINARY NET INCOME OR LOSS.—After excluding all items of either short-term or long-term capital gain or loss, there shall be computed—

(A) An ordinary net income which shall consist of the excess of the gross income over the deductions; or

(B) An ordinary net loss which shall consist of the excess of the deductions over the gross income.

Treasury Regulations 77, promulgated under the Revenue Act of 1932:

ART. 121. *Business expenses.*—Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, except the classes of items which are deductible under the provisions of articles 141–272. The cost of goods purchased for resale, with proper adjustment for opening and closing

inventories, is deducted from gross sales in computing gross income. (See article 55.) Among the items included in business expenses are management expenses, commissions, labor, supplies, incidental repairs, operating expenses of automobiles used in the trade or business, traveling expenses while away from home solely in the pursuit of a trade or business (see article 122), advertising and other selling expenses, together with insurance premiums against fire, storm, theft, accident, or other similar losses in the case of a business, and rental for the use of business property. A taxpayer is entitled to deduct the necessary expenses paid in carrying on his business from his gross income from whatever source. As to items not deductible, see section 24 and articles 281–284.

ART. 282. *Capital expenditures.*—Amounts paid for increasing the capital value or for making good the depreciation for which a deduction has been made) of property are not deductible from gross income. (See section 23 (k) and article 201.) Amounts expended for securing a copyright and plates, which remain the property of the person making the payments, are investments of capital. The cost of defending or perfecting title to property constitutes a part of the cost of the property and is not a deductible expense. The amount expended for architects' services is part of the cost of the building. Commissions paid in purchasing securities are a part of the cost price of such securities. Commissions paid in selling securities, when such commissions are not an ordinary and necessary business expense, are an offset against the selling price. * * *

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